



United States General Accounting Office  
Washington, DC 20548

December 13, 2001

The Honorable Christopher S. Bond  
Ranking Minority Member  
Committee on Small Business and Entrepreneurship  
United States Senate

Subject: Small Business Subcontracting Report Validation Can Be Improved

Dear Senator Bond:

This letter responds to your request that we assess how agencies validate data submitted by prime contractors on their subcontracting achievements. Subcontracting is an important avenue for enabling small businesses to participate in large dollar federal contracts. Of a total of \$77 billion reported subcontracted dollars in fiscal year 2000, \$31 billion went to various types of small businesses, such as women-owned, and small disadvantaged businesses, as well as those located in historically underutilized business zones called HUBZones.

You also requested that we answer two specific questions on subcontracting substitution and evaluations of contractor past performance. Our responses are provided in enclosure III.

#### **RESULTS IN BRIEF**

Civilian and defense agencies follow a similar process to validate their subcontracting data—one that involves visiting contractors, assessing their compliance with their subcontracting plans, and evaluating accounting systems as well as management support of the subcontracting program. These assessments have found that most contractors that were reviewed are making good faith efforts to comply with their subcontracting plans. However, there are some areas where these reviews could be improved in order to enhance the validation and use of subcontracting data, and we have identified actions that can be taken to bring about these improvements. We received written comments on a draft of this letter from the Department of Defense (DOD) and the Small Business Administration (SBA). DOD concurred with our findings and recommendations and had no further comment. SBA also concurred with our recommendations but expressed concerns about how we characterized SBA's compliance efforts. DOD's and SBA's written comments are provided in enclosures I and II.

## BACKGROUND

Under the Small Business Subcontracting Program,<sup>1</sup> a contractor is not required to subcontract with small businesses, but in receiving a contract for more than \$100,000, the contractor must agree in the contract that various types of small businesses will have the “maximum practical opportunity” to participate in contract performance. A prospective contractor is required to submit a subcontracting plan for each solicitation or contract modification that individually is \$500,000 or more (\$1 million for construction contracts) and that has subcontracting possibilities.<sup>2</sup> DOD accounts for about \$55 billion, or 71 percent, of the reported subcontracting dollars, and the civilian agencies account for about \$22 billion, or 29 percent.

The plan must document what actions the prospective contractor will take to provide the various types of small businesses with the maximum practical opportunities to participate in subcontracting. Specifically, it must include, among other things:

- the percentage goals that will be subcontracted to specific types of small businesses,
- the total dollars planned to be subcontracted and the contractor’s total subcontracting dollars to these businesses,
- the type of work to be subcontracted and the types planned for subcontracting to these businesses, and
- the efforts the contractor will make to ensure subcontracting opportunities to these businesses.<sup>3</sup>

After contracts are awarded, the contractor must periodically submit to the government a subcontracting report for each individual contract that contains a subcontracting plan, which includes the subcontracting goals and dollars awarded to the various types of small businesses.<sup>4</sup> The contractor must also submit a summary subcontracting report that encompasses all its contracts with a particular agency within a fiscal year, including the total dollars subcontracted to various types of small businesses.

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<sup>1</sup> Federal Acquisition Regulation (FAR) 19.7.

<sup>2</sup> FAR 19.702. However, subcontracting plans are not required (1) from small businesses; (2) for personal services contracts; (3) for contracts or contract modifications performed outside a state, territory, or possession of the United States, the District of Columbia, and the Commonwealth of Puerto Rico; or (4) for modifications of contracts within the general scope of the contract that do not contain the clause at FAR 52.219-8, Utilization of Small Business Concerns.

<sup>3</sup> FAR 19.704(a) (1) (2) (3) (8).

<sup>4</sup> Contractors under DOD’s Comprehensive Subcontracting Plan Test Program would not report on individual contracts. Instead, the test program authorizes the negotiation, administration, and reporting of subcontracting plans on a plant, division, or companywide basis as appropriate. At the time of our review, DOD had 20 active plans with contractors under this test program.

## **AGENCIES USE DCMA AND SBA TO VALIDATE DATA**

Civilian agencies rely on SBA and DOD relies on the Defense Contract Management Agency (DCMA) to validate information provided by contractors or otherwise measure contractor compliance with their subcontracting plans. Both SBA and DCMA take similar approaches to validating compliance through on-site reviews of contractors—visiting and interviewing contractors, reviewing a sample of subcontracting plans and the contractors' policies and procedures for implementing their small business program, and rating contractors based on their assessments.<sup>5</sup> Both agencies found that most contractors that were reviewed were making good faith efforts to achieve their subcontracting goals. Specifically, for fiscal year 2000, SBA reported that only 3 percent of the contractors it reviewed were performing in a less than acceptable manner, while DCMA found that 8 percent were performing in a less than an acceptable manner. Both DCMA and SBA work with contractors who have unacceptable ratings to bring them into compliance.

## **DIFFERENCES IN APPROACHES**

There are differences between the DCMA and SBA reviews of contractors' subcontracting programs. DCMA reviews more contractors with subcontracting plans than SBA. Specifically, the small business specialists that carry out DCMA reviews reported that they performed on-site reviews of about 93 percent of their portfolio of 1,010 contractors with subcontracting plans in fiscal year 2000. SBA reviewers, by contrast, reported that they performed on-site reviews of about 15 percent of their portfolio of 1,780 contractors with subcontracting plans.<sup>6</sup> Both SBA and DCMA have guidance that instructs reviewers to prioritize reviews according to compliance risks such as the date of last review and the number of contracts not meeting established goals. Unlike DCMA, SBA on-site reviews are not always done according to the compliance risks posed by the contractor. Instead, they are done based on the time available to do the reviews and the proximity of the contractor to the reviewer because of travel and staff limitations, according to SBA officials. This approach does not ensure that the highest risk contracts are adequately covered.

In addition, DCMA consistently submits its findings to responsible contracting officers. SBA does not consistently do this—even in cases when the contractors received marginal ratings. This is important since the contracting officer is responsible for monitoring the contractor's performance.<sup>7</sup>

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<sup>5</sup> SBA and DCMA have an agreement that ensures that both agencies' compliance review process and ratings are similar.

<sup>6</sup> SBA officials said they conducted 894 desk reviews in fiscal year 2000 of contractors' performance in addition to the on-site reviews of contractors' subcontracting programs. Desk reviews, also called "performance reviews," are used to identify contractors not meeting their subcontracting goals. However, these desk reviews do not assess the validity of the provided data or rate how well contractors are performing on their subcontracting plans.

<sup>7</sup> FAR 19.706.

Neither SBA nor DCMA summarizes the results of their reviews in ways that would facilitate assessments of subcontracting data governmentwide (e.g., in terms of what percentage of contractors are meeting their goals for a given year and what progress contractors are making over time in terms of dollars awarded, goals achieved, or ratings). SBA maintains a database containing contractor ratings, but it is not complete and up-to-date and it does not readily provide information on trends regarding compliance with subcontracting plans. DCMA has two districts, which collect information on their reviews, but the agency does not maintain a centralized agencywide database. Both SBA and DCMA are aware of the limitations of their data collection and reporting systems and are working to develop databases that would address some of these issues. SBA plans to have a new subcontracting database operating by December 2001, and DCMA plans to have a new agencywide subcontracting database in 6 to 9 months.

Further details on how DCMA and SBA conduct their reviews are provided in table 1.

**Table 1: Steps Generally Taken to Review Compliance with Subcontracting Plans**

<ul style="list-style-type: none"> <li>• Evaluate how the contractor maintains an accounting system that collects information the contractor needs to prepare its subcontract reports.</li> </ul>	<ul style="list-style-type: none"> <li>• Select a sample of subcontracting plans and determine whether the contracting officer responsible for that contract has approved any goal modifications or special exemptions from goals.</li> </ul>
<ul style="list-style-type: none"> <li>• Assess whether the contractor has achieved its subcontracting goals.</li> </ul>	<ul style="list-style-type: none"> <li>• Track sample invoices to verify dollar amounts on subcontracting reports.</li> </ul>
<ul style="list-style-type: none"> <li>• Assess actions the contractor has taken to improve program performance.</li> </ul>	<ul style="list-style-type: none"> <li>• Determine whether a subcontractor's self-certification of each of the categories of small businesses meets the FAR definition of that category of small business.</li> </ul>
<ul style="list-style-type: none"> <li>• Assess written policies and procedures on the contractor's small business program.</li> </ul>	<ul style="list-style-type: none"> <li>• Assess upper management support of the small business program.</li> </ul>
<ul style="list-style-type: none"> <li>• Assess the contractor's practices to ensure accurate reporting.</li> </ul>	<ul style="list-style-type: none"> <li>• Based on the on-site compliance review, rate the contractor as outstanding, highly successful, acceptable, marginal, or unacceptable.</li> </ul>
<ul style="list-style-type: none"> <li>• Assess compliance with recordkeeping requirements.</li> </ul>	<ul style="list-style-type: none"> <li>• Report this rating to the contractor along with recommendations to improve performance.</li> </ul>
<ul style="list-style-type: none"> <li>• Assess the effectiveness of the contractor's small business training program.</li> </ul>	

## CONCLUSIONS AND RECOMMENDATIONS FOR EXECUTIVE ACTION

While SBA and DCMA reviews of contractor-reported data look at a range of important factors, such as management support and controls and actual performance, SBA's approach does not ensure that the highest risk contractors are adequately covered or that the officials responsible for monitoring contractor performance are aware of the results of reviews. Moreover, assessing the validity of subcontracting data governmentwide is difficult because SBA and DCMA do not readily summarize the results of their reviews in terms that would allow governmentwide assessments of contractor performance. At a minimum, both agencies could examine whether it is cost-effective to take additional steps that would enhance the validation and use of subcontracting data.

We recommend, therefore, that the Administrator of SBA determine whether it is cost-effective to do the following and, if so, implement these steps.

- Base SBA contractor reviews on compliance risks, such as size of the contract, date of the last review, and previous ratings, rather than time available to do the reviews and proximity of the contractors to the reviewer.
- Send the results of the reviews to contracting officers, especially when the ratings are marginal.

To promote governmentwide oversight, we also recommend that both the Director of DCMA and the Administrator of SBA develop reports that summarize their reviews; for example, in terms of the percentage of contractors meeting their goals and the progress being made over time.

## AGENCY COMMENTS AND OUR EVALUATION

We received written comments on a draft of this letter from DOD and SBA. DOD concurred with our findings and recommendations and had no further comment. SBA also concurred with our recommendations but expressed three concerns.

First, SBA suggested that we combine the number of desk reviews with the on-site reviews in our discussion of SBA's compliance review effort. We noted in the report the number of desk reviews that SBA conducted in fiscal year 2000. However, because desk reviews do not validate contractor-provided data or rate how contractors are performing on their subcontracting plans, we believe that including such reviews with the more comprehensive on-site reviews would be misleading.

Second, SBA notes that its guidance instructs reviewers to prioritize reviews according to compliance risks and that its staff may defer an on-site review of a contractor if the desk review indicates that the company is meeting the majority of its subcontracting goals. As we noted in the letter, SBA's guidance takes compliance risk into consideration. However, the SBA reviewers we interviewed said that they generally visit contractors based on the time available to do the reviews and the proximity of the contractors to the reviewer because of travel and staff limitations, rather than the compliance risks posed by the contractor.

Third, SBA noted that it has collected subcontracting data for over 10 years and that much of the information is summarized in a meaningful way. While SBA's database does provide some useful information, the data was not always complete and up-to-date and did not readily provide information on trends regarding compliance with subcontracting plans. DOD's and SBA's comments appear in enclosures I and II.

## SCOPE AND METHODOLOGY

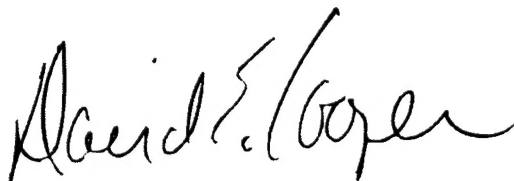
To assess how agencies validate information provided by prime contractors on their subcontracting achievements, we analyzed pertinent legislation and agency documents and interviewed officials at SBA, DOD, the Department of Energy, and the National Aeronautics and Space Administration. In addition, we surveyed DCMA and SBA staff who reviewed prime contractors' subcontracting programs. We conducted our review from October 2000 to August 2001 in accordance with generally accepted auditing standards.

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As agreed with your office, unless you publicly announce the contents of this letter earlier, we will not distribute this report until 30 days from its date. At that time, we will send copies of this letter to the Chairman of the Senate Committee on Small Business and Entrepreneurship, the Director of DCMA, and the Administrator of SBA. We will also make copies available to others upon request.

If you have any questions concerning this letter, please call me at (617) 565-7555. Key contributors to this review also included Catherine Baltzell, Thom Barger, David Bennett, Deatra Brandon, Cristina Chaplain, Judith Collins, Sylvia Schatz, James Smoak, and Hilary Sullivan.

Sincerely yours,

A handwritten signature in black ink, appearing to read "David E. Cooper". The signature is fluid and cursive, with the first name "David" being the most prominent.

David E. Cooper  
Director, Acquisition and Sourcing Management

Comments From the U.S. Small Business Administration



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

NOV 27 2001

Ms. Hilary Sullivan  
Assistant Director  
Acquisition and Sourcing Management  
U.S. General Accounting Office  
1999 Bryan Street  
Suite 2200  
Dallas, TX 75201-6848

Dear Ms. Sullivan:

Thank you for your letter of October 31, 2001, providing us an opportunity to review and comment on your draft *Letter of Correspondence* entitled "Small Business: Subcontracting Report Validation Can Be Improved" (GAO-02-166R). The principal point of contact at the U.S. Small Business Administration (SBA) for this project is Robert Taylor, Subcontracting Program Manager. I wish to commend you on your thorough review. Your observations will be extremely helpful as we examine the subcontracting program and seek ways to improve our oversight of the subcontracting achievements of Federal prime contractors. There are, however, several instances in which the reader could possibly misinterpret some of the findings and recommendations.

Under an agreement signed by the SBA and the Defense Contract Management Agency (DCMA) in 1996, the DCMA has primary responsibility for the compliance reviews of Department of Defense (DOD) contractors, while the SBA has primary responsibility for the compliance reviews of civilian agency contractors. In your discussion of the differences in approaches between the two agencies, you state that DCMA reviewed 93 percent of its portfolio of 1,010 prime contractors in fiscal year 2000, while the SBA reviewed only 15 percent of its portfolio of 1,780 prime contractors during the same period. In a footnote, you correctly point out that the SBA also conducted 894 desk reviews, or "performance reviews" during fiscal year 2000. These desk reviews are valuable because they are used to determine which prime contractors are not meeting their subcontracting goals. This information is used to identify high risk contractors and to prioritize the on-site reviews that we conduct later in the year.

In fiscal year 2000, the SBA conducted 252 on-site reviews and 894 desk reviews, or 1,096 reviews in total. This total represents 62 percent of the 1,780 companies under the SBA's cognizance. We believe that this figure provides a more accurate picture of the SBA's efforts in the area of compliance and should be included in the letter.



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Ms. Hilary Sullivan

Page 2

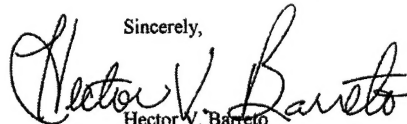
Your letter states that the SBA on-site reviews are not always done according to the compliance risks posed by the contractor; rather, they are done based on the time available to do the review and the proximity of the contractor to the reviewer because of travel and staff limitations. You do note that both the SBA and the DCMA have guidance that instructs reviewers to prioritize reviews according to compliance risks. The SBA has, indeed, incorporated this guidance into its Standard Operating Procedures (SOP) for the Subcontracting Assistance Program (SOP 60 03 5). Sometimes, however, we defer an on-site review of a contractor to the following year, especially if a desk review indicates that the company is meeting the majority of its subcontracting goals.

Your letter states that neither the SBA nor the DCMA summarize the results of their reviews in ways that would facilitate assessments of subcontracting data government-wide. We wish to point out that the SBA has collected subcontracting data for more than 10 years, including both subcontracting dollars and the results of our compliance reviews. Much of this information is, summarized in a meaningful way. However, we agree that both the SBA and the DCMA could improve its automated systems used to accomplish this. As mentioned, the SBA will have a new subcontracting database before the end of the current calendar year that will be an important step towards satisfying your concerns. The new system will import critical information from the Federal Procurement Data System (FPDS), including the names of new contractors with contracts containing subcontracting plans. This will help to ensure that every contractor with a subcontracting plan is accounted for and closely monitored.

With respect to the first recommendation, we are reviewing our procedures that require SBA field staff to prioritize reviews according to compliance risks to determine if they can be strengthened. We agree with your second recommendation that the SBA should submit its compliance findings to the responsible contracting officers. We have taken steps to begin this immediately.

We thank you and your staff for their cooperation and recommendations for improving SBA's role in conducting compliance reviews. We look forward to receiving the final document.

Sincerely,



Hector V. Barreto  
Administrator



Comments From the Department of Defense



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

20 SEP 2001

Ms. Hilary Sullivan  
Assistant Director  
Acquisition and Sourcing Management  
U.S. General Accounting Office  
1999 Bryan Street, Suite 2200  
Dallas, Texas 75201

Dear Ms. Sullivan:

This is the Department of Defense (DoD) response to the GAO draft report, "Small Business Subcontracting Report Validation Can Be Improved," dated October 31, 2001 (GAO Code 120003/GAO-02-166R).

The Department recognizes the importance of subcontracting achievements to the overall small business program. DoD subcontract awards to small business firms in FY2000 exceeded \$21 billion. This coupled with almost \$27 billion in prime contract awards afforded the small business community revenue equating to more than 39 percent of DoD awards to U.S. business firms. The Department shares the Congress' concern that subcontracting achievements are accurately reflected in reports submitted by DoD contractors.

The GAO report highlights the effectiveness of the Defense Contract Management Agency (DCMA) process for the review and validation of data submitted by contractors on their small business subcontracting achievements. The DCMA process is characterized by prioritization of reviews according to compliance risks, follow-up with contractors that have not received an acceptable rating to ensure future compliance, and reporting findings of the reviews to the appropriate contracting officer. The DoD concurs in the recommendation that DCMA develop reports summarizing these reviews using readily available data.

Thank you for the opportunity to review and comment on the draft report.

Sincerely,

FRANK M. RAMOS  
Director, Small and Disadvantaged  
Business Utilization



**GAO DRAFT REPORT - DATED OCTOBER 31, 2001  
GAO CODE 120003/GAO-02-166R**

**"SMALL BUSINESS SUBCONTRACTING REPORT VALIDATION  
CAN BE IMPROVED"**

**DEPARTMENT OF DEFENSE COMMENTS  
TO THE RECOMMENDATIONS**

**RECOMMENDATION:** The GAO recommended that the Defense Contract Management Agency develop readily available reports that summarize their reviews; for example, in terms of a percentage of contractors meeting their goals and the progress made over time. (p.8/GAO Draft Report)

**DOD RESPONSE: CONCUR.** Contractor review data is currently electronically collected in only one DCMA district; this data collection system will be expanded to include both Districts within six (6) months.

ANSWERS TO QUESTIONS ON SUBSTUTION OF SUBCONTRACTORS AND  
EVALUATIONS OF PAST PERFORMANCE

**To what extent are defense contractors substituting subcontractors?**

Subcontracting plans may or may not specifically identify small, small disadvantaged, and women-owned small businesses. When they do, prime contractors should notify the administrative contracting officer of any substitution of firms that are not small, small disadvantaged or women-owned small businesses.<sup>8</sup> However, DOD officials said that contracting officers do not typically require contractors to specifically identify businesses in subcontracting plans and they did not maintain data on how often substitution occurred.

**How are prime contractors' past performance in meeting its small business subcontracting goals considered in awarding new contracts?**

Past performance information is one indicator of a prospective contractor's ability to perform successfully. The currency and relevance of the information, source of the information, context of the data, and general trends in a contractor's performance should be considered in making award decisions. The evaluation factors that may apply to an acquisition and their relative importance are within the broad discretion of agency acquisition officials.<sup>9</sup> Among the factors that may be considered is a prospective contractor's past performance in complying with subcontracting plan goals for small disadvantaged business concerns.<sup>10</sup> However, NASA, DOE and DOD officials said that past performance evaluation factors varied from contract to contract and they did not have data on how past performance on subcontracting plan compliance was used in contract award decisions.

(120003)

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<sup>8</sup> Defense Federal Acquisition Regulation Supplement 219.704-Subcontracting Plan Requirements.

<sup>9</sup> Federal Acquisition Regulation (FAR) 15.3 04-Evaluation factors and significant subfactors

<sup>10</sup> FAR 15.305-Proposal evaluation.